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SUBJECT: Effects of U.S. Financial Crisis on Vietnam

REF: Hanoi 1095

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¶1. (SBU) Summary: The short term effects of the U.S. financial crisis in Vietnam have been minimal; local banks, while suffering from domestic troubles, are not heavily invested in sub-prime debt. Longer term questions remain, however, as a global downturn may affect exports and both direct and indirect capital flows. The GVN is aware of the downside risks and is evaluating its plans for 2009 accordingly. End Summary.

Short Term Effects are Negligible

¶2. (SBU) In the short term, most analysts agree Vietnam will not suffer severe adverse consequences as a result of the financial crisis in the United States and elsewhere. Vietnam's fledgling banks are not heavily invested in mortgage-backed securities or derivatives, nor are they dependent on foreign financing. As a result, the State Bank of Vietnam (SBV) has taken a relaxed stance on the immediate effects of the turmoil in the U.S. On September 30, SBV Governor Giau told a press conference that "I do not see any impact that the U.S. financial crisis would bring to Vietnam's banking sector." Press reports a couple of days later indicated that some local banks had withdrawn money from certain foreign banks and reinvested the money in "prestigious banks in Hong Kong and Singapore," but there have been no "bank runs" or other public displays of panic.

¶3. (SBU) As previously reported, some of Vietnam's banks are troubled, but those troubles are a result of internal causes such as high credit growth, inflation, interest rate caps and poor management/supervision, not sub-prime debt exposure (reftel). The collapse or merger of many of the larger U.S. financial institutions may mean that banks in Vietnam will have a more difficult time finding foreign strategic partners, and foreign banks operating in Vietnam (like HSBC) might take a second look at their expansion plans.

¶4. (SBU) Global market psychology has affected Vietnam's stock market; it has risen and fallen with the rest of the Asian markets over the last couple of weeks. On September 30th, the market dropped 4.7 percent, to 456, following news that the bailout plan failed in the House, but such a percentage drop is not unusual in Vietnam's thin market. The State Securities Commission (SSC) was unfazed, telling the Embassy that they thought the market would be "down for four days" but then recover. The market did better than predicted initially, dropping by only .5 percent the following day and then rising back up to 460 on October 2. On October 3 and 6,

the market was down a total of 8.5 percent and as of October 9, it had finally fallen below 400. Vietnam's stock market had a large negative adjustment earlier in the year, however, and the movements now are small in comparison.

Risks to Exports and FDI Remain

¶5. (SBU) Analysts and economists agree that the more critical issue for Vietnam is the long-term effect of the U.S. financial crisis. Vietnam is heavily dependent on exports and foreign direct investment (FDI), so a global slowdown could have serious adverse affects on its balance of payments. Exports are the obvious downside risk as economic growth slows in Vietnam's major foreign markets. A slowdown in exports will also bring a reduction in imports, but it is unlikely that imports will slow as much as exports. The World Bank in Hanoi is currently examining this issue to see if it can measure how Vietnam's balance of payments will be affected by a drop in exports.

¶6. (SBU) Less certain is the financial crisis' effect on FDI. Vietnam has been posting very high numbers of committed FDI throughout 2008 (over $44 million for 1H 2008), but many analysts feel that implemented FDI will take a hit as a result of the U.S. financial turmoil. Pledged investment is calculated from signed investment licenses and is a useful indicator of investor sentiment and GVN plans for the future. The amount of FDI disbursed in 2008 will probably grow to around $8-10 billion at year's end, up from $5 billion in 2007. As credit becomes more scarce and risk less tolerable, investors in emerging markets like Vietnam may lose their financing commitments or simply rethink their business plans. Local economists are already urging the GVN to use investment capital efficiently and to select projects carefully, a message that will become even more critical if FDI commitments drop significantly.

Slumping FII Flows and Fund Share Prices

¶7. (SBU) Vietnam financial sector analysts note that U.S. financial sector's difficulties present two other reasons for potential concern in Vietnam. First, "hot money" inflows of foreign indirect investment (FII) could dry up completely, increasing Vietnam's current account deficit and potentially putting pressure on Vietnamese dong (VND) exchange rates. FII inflows are already down sharply due to the macroeconomic problems Vietnam has experienced this year, as much as 75 to 80 percent according to one fund manager. At the same time, most funds in Vietnam are closed-end, meaning that foreign investors are not able to pull their capital out except by selling the listed shares. In a recent Vietstock interview, Nguyen Son, Head of the Market Development Department under the State Securities Commission, estimated the total value of foreign portfolio investment in Vietnam currently at $7-8 billion. Most industry professionals estimate that FII flows are still slightly positive.

¶8. (SBU) The second follow-on effect affects fund share prices. Strapped for cash overseas investors have been selling shares in listed funds (e.g., Vinacapital's Vietnam Opportunity Fund -- VOF), reducing the difference between the fund's share price and the underlying net asset value (NAV) of the fund's holdings, and putting pressure on fund managers. As the funds' share prices drop, some funds are buying back their own shares to prevent a situation in which the NAV exceeds the market value of the fund's share price. If the fund's share price discount to NAV is particularly wide, this creates an opportunity for another firm or investor to acquire enough shares to take control of the fund, then sell off the assets and pocket the difference. Widening discounts to NAV also makes it difficult for the funds to raise new capital (which must be raised at the NAV so as to not dilute existing shareholders).

GVN Response

¶9. (SBU) The GVN is aware of the issues it may face as a result of a global downturn. The PM recently tasked various ministries and agencies with preparing a report on the possible domestic ramifications of the crisis. He also continues to advocate publically for increasing exports and making Vietnam attractive for foreign investors as a means of staving off slowing demand from the U.S. and Europe. Communist Party head Nong Duc Manh, while not referring directly to the U.S., recently directed the Central Committee to evaluate its economic plans for 2009 "in light of the international situation."

¶10. (SBU) Our interlocutors in the GVN are also keenly interested in the latest news. Many of our bilateral meetings begin or end with questions about the bailout plan, the debate in Congress, and when the U.S. economy might recover. As Finance Vice Minister Ha recently said after receiving an update, "Well, we want to know because we will get better when you get better." Press coverage has been extensive but rational and balanced thus far.

Comment

¶11. (SBU) Fortunately, the GVN is aware of Vietnam's susceptibility to problems in the U.S. and, at least on paper, seems serious about proactive solutions. Some analysts are privately speculating that the Communist Party may use our financial crisis as an excuse to slow the ongoing reform and equitization process for Vietnam's SOEs, but most are focused on the more obvious impacts to the macroeconomy. Post will continue to follow these issues and report septel.

¶12. (U) This cable was written in conjunction with Con Gen HCMC.

MICHALAK